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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

CENTURION PARTNERS SERVICES,

Plaintiff and Respondent,

v.

CHARLES M. DAVIS,

Defendant and Appellant.

G039706

(Super. Ct. No. 05CC07206)

O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, Sheila Fell, Judge. Affirmed in part and reversed in part.

Specter & Willoughby, Michael L. Willoughby and Mark Anthony Rodriguez for Defendant and Appellant.

Pircher, Nichols & Meeks and James L. Goldman for Plaintiff and Respondent.

The trial court found Charles M. Davis to be the alter ego of American Automotive Group (AAG), and therefore, jointly and severally liable for damages arising from a breach of contract action brought by Centurion Partners Services (Centurion). On appeal, Davis challenges the court's alter ego finding, claiming it is not supported by sufficient evidence. We agree Centurion did not meet its burden of proof on the alter ego issue and the court's ruling on this issue must be reversed. In all other respects, the judgment is affirmed.

I

The Contracts

The facts underlying the breach of contract action are not in dispute and can be simply stated as follows: In September 2004, Equitable Life Insurance, an affiliate of AXA Reinsurance (AXA) subleased a portion of a Newport Beach office building to AAG. A few months later, on January 7, 2005, AAG subleased a portion of the premises to Centurion.

Centurion agreed to start paying AAG, in April, \$5,500 monthly rent. Centurion also paid a security deposit and the first and last month's rent in the sum of \$16,500.

At the same time, AAG was in material breach of its obligations to AXA. It had not made its January, February, or March rent payments to AXA (owing \$33,000). When Centurion moved into the building in April, it received notice AAG was in default under its sublease for failing to obtain the landlord's consent to the AAG/Centurion sublease and for failing to pay three months of rent.

Having just incurred substantial expense to move and transfer its operations, Centurion arranged directly with AXA for a new sublease for the office space which commenced May 1, 2005. As part of the agreement, Centurion agreed to also pay some of the money still owed by AAG, and it obtained an assignment to claims AXA had against AAG. AAG vacated the office space.

The Procedural History

In April 2005, Centurion filed an action against AAG and Davis for breach of contract, breach of the implied covenant of good faith and fair dealing, and fraud in the inducement. Because Davis was not a party to the AAG/Centurion sublease agreement, Davis's liability was premised on allegations Davis's actions, as the stockholder, officer, and director of AAG, warranted application of the alter ego doctrine. Davis and AAG filed general denials to the complaint.

During discovery, Centurion sent form interrogatories asking Davis and AAG to state all facts and identify documents that supported special or affirmative defenses. Centurion was surprised when Davis did not identify the alter ego allegation as an affirmative defense and Davis failed to identify any evidence relating to this issue. Instead, Davis and AAG noted the only affirmative defenses were: (1) Centurion failed to mitigate their damages and should not have paid the rent demanded by AXA; and (2) Centurion had unclean hands.

Centurion also sent requests for admissions. Only the last two questions addressed the alter ego issue (as well as the fraud allegation). First, AAG conceded it was already in default when it executed the AAG/Centurion sublease. However, it denied the assertion that "At the time when Centurion and AAG entered into the . . . agreement, AAG had no ability of making any further payments under the AAG sublease because of its precarious financial condition." In response to the request for evidence or documents to support this denial, AAG stated it "believed that it had the ability to continue making payments under its sublease when it executed the lease with [Centurion.]" However, it failed to identify witnesses or documents to support this assertion.

Centurion next made a request for production of documents, seeking copies of Davis's and AAG's financial statements and bank records. Davis and AAG made

general objections to the requests. In response to the request for financial records, AAG produced only a single projected balance sheet dated July 31, 2004.

Centurion subsequently took Davis's deposition, which is not part of this record. There is nothing in the record indicating AAG was asked to produce its corporate records (other than financial and bank statements), relating to whether corporate formalities were followed or whether the corporate records were properly segregated.

The Trial

Centurion's counsel submitted his testimony by way of a declaration. He stated he obtained from California's Secretary of State a report showing AAG's corporate status was suspended on November 24, 2004—two months before Davis negotiated the AAG/Centurion sublease agreement.

In addition, Centurion's counsel stated the only financial statement received from AAG in response to discovery requests was a purported "balance sheet for 'Jammin Dodge Chrysler Jeep/AAG' for the period ended July 31, 2004 [(marked Trial Exhibit No. 2)]. No income statement or other balance for AAG was produced; no financial statement for Davis was produced; and no bank records for either AAG or Davis were produced. At his deposition[,] Davis testified that Trial Exhibit No. 2 was, in essence, a pro forma balance sheet and was based on the assumption that AAG would acquire a Chrysler Jeep auto dealership, that the transaction did not occur, and that the assets identified on the balance sheet were never available to AAG to satisfy its ongoing obligations."

At the start of the trial, AAG's and Davis's counsel announced he learned a few days prior that AAG was misidentified in the pleadings as a California corporation. Counsel explained AAG, the California corporation merged in 2003 with a Florida corporation, I-Incubator.com, Inc. After the merger, the name of the surviving Florida corporation became AAG. Accordingly, he argued the party contracting with Centurion was AAG, the Florida corporation in good standing.

Davis testified all the discovery responses and testimony he gave regarding AAG related to the Florida entity. Davis stated he believed the Florida corporation was licensed to do business in California, but he did not have any proof with him. Davis stated the board of directors was himself, John Rock (his brother), Robert Laube, and Daryl Travis. He explained the board had meetings telephonically. They often had meetings to discuss the acquisition of car dealerships.

Davis stated AAG also conferred with two sets of attorneys about these transactions, and he believed the attorneys assisted in preparing corporate documents, such as resolutions. Davis stated nobody had asked him during discovery to produce any board of directors resolutions. Davis asserted the corporation had financial records and other documents showing corporate formalities were followed. AAG had business cards, Wells Fargo checks, stationary, and a sign on the office door. Davis stated the company had 300 shareholders, and he personally owned 15 million shares, which was approximately 15 percent of the overall company.

Davis acknowledged telling counsel at his deposition that he would “look into” whether there was further written evidence supporting his claim AAG was sufficiently funded. He explained the financial documents were in files kept in storage by Chuck Bennington (AAG’s chief operating officer), who refused to return Davis’s many telephone calls. Davis claimed he also contacted Wells Fargo, which indicated it would take several weeks to get copies of statements because the account was closed. Finally, Davis testified AAG fell on hard times in early 2005 because several business deals fell through. He opined AAG was able to satisfy its rent obligations in January and February because AXA could have used its \$32,000 security deposit.

The Tentative Decision

After considering the evidence and the testimony, the court stated in its minute order, “The Answer identified . . . AAG as a California corporation. In answer to an interrogatory, . . . Davis testified that ‘[AAG] was incorporated as a California

corporation in October 2002, and has never used any other name.’ . . . Centurion provided convincing evidence that the corporate status of AAG was suspended by the California Secretary of State in November 2004. For the first time, on the day of trial . . . Davis reported that the contracting Defendant was really a Florida corporation rather than a California corporation. The court finds this revelation disingenuous and has not given credence to Davis’s assertion. The court believes that Davis intended the contracting party to be the California corporation: He never gave notice to plaintiff that there was a Florida corporation, and Davis’s responses to interrogatories indicated AAG was a California corporation. . . . Davis at all times relevant was not entitled to corporate shielding as and against personal liability when he acted as the corporation without it having valid legal status. The corporate veil was pierced by Davis’s actions. The court is persuaded from evidence admitted at trial that Davis had a reasonable belief at the time he entered into the sublease agreement that he and AAG could perform on the obligations as they came due. As such, insufficient evidence was presented to establish fraud on the part of Davis. Based on the above, the court awards judgment in favor of . . . Centurion Judgment is awarded in the amount of \$45,256 jointly and severally as and against . . . [AAG and Davis].”

Centurion made a motion requesting an award of prejudgment interest. Davis and AAG filed an objection to the tentative decision, stating there was insufficient evidence to decide the alter ego issue in Centurion’s favor. They argued AAG’s status as a suspended corporation has the legal effect of rendering the contract voidable, but this fact was not the basis for alter ego liability. They also moved for a new trial.

The Statement of Decision

The court adopted its tentative decision as the statement of decision, except it ordered prejudgment interest of \$9,757.80. It stated AAG’s and Davis’s arguments were rejected, “In determining that Davis is personally liable to [Centurion] on the basis that AAG is his alter ego, the court relies on all of the evidence in the record and on the

arguments made by [Centurion] in its post-trial briefs, in its opposition to [Davis's] objection, and at the hearing on July 31, 2007.” In its minute order regarding the July 31, 2007, hearing, the court elaborated, “[The] court has reviewed [the basis] for finding alter ego [N]ot only was the corporation suspended, but also Davis treated the rental income [\$16,500] as his personal funds and he also treated the additional monthly income as his own funds.”

II

A Brief Overview of the Alter Ego Doctrine

“Ordinarily, a corporation is regarded as a legal entity, separate and distinct from its stockholders, officers, and directors, with separate and distinct liabilities and obligations. [Citations.] A corporate identity may be disregarded—the ‘corporate veil’ pierced—where an abuse of the corporate privilege justifies holding the equitable ownership of a corporation liable for the actions of the corporation. [Citation.] Under the alter ego doctrine, then, when the corporate form is used to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose, the courts will ignore the corporate entity and deem the corporation’s acts to be those of the persons or organizations actually controlling the corporation, in most instances the equitable owners. [Citations.] The alter ego doctrine prevents individuals or other corporations from misusing the corporate laws by the device of a sham corporate entity formed for the purpose of committing fraud or other misdeeds. [Citation.]” (*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 538 (*Sonora Diamond*).)

The court in *Sonora Diamond* examined the showing required to establish alter ego liability. “In California, two conditions must be met before the alter ego doctrine will be invoked. First, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone.

[Citations.] ‘Among the factors to be considered in applying the doctrine are commingling of funds and other assets of the two entities, the holding out by one entity that it is liable for the debts of the other, identical equitable ownership in the two entities, use of the same offices and employees, and use of one as a mere shell or conduit for the affairs of the other.’ [Citations.] Other factors which have been described in the case law include inadequate capitalization, disregard of corporate formalities, lack of segregation of corporate records, and identical directors and officers. [Citations.] No one characteristic governs, but the courts must look at all the circumstances to determine whether the doctrine should be applied. [Citation.] Alter ego is an extreme remedy, sparingly used. [Citation.]” (*Sonora Diamond, supra*, 83 Cal.App.4th at pp. 538-539.)

The plaintiff creditor bears the burden of pleading and establishing alter ego liability. (*Minifie v. Rowley* (1921) 187 Cal. 481, 488.) Specifically, “It is the plaintiff’s burden to overcome the presumption of the separate existence of the corporate entity.” [Citation.]” (*Mid-Century Ins. Co. v. Gardner* (1992) 9 Cal.App.4th 1205, 1212.)

Whether the corporate existence will be disregarded “is primarily one for the trial court and is not a question of law, the conclusion of the trier of fact will not be disturbed if it is supported by substantial evidence. [Citations.]” (*Alexander v. Abbey of the Chimes* (1980) 104 Cal.App.3d 39, 47.) When a challenge is made to the sufficiency of the evidence, we must review the entire record and view all factual matters in the light most favorable to the prevailing party and the judgment. (*Washington v. Farlice* (1991) 1 Cal.App.4th 766, 771-772.) We do not reweigh the evidence or resolve conflicts in the evidence or in the reasonable inferences that may be drawn from the evidence. (*White v. Inbound Aviation* (1999) 69 Cal.App.4th 910, 927.)

Insufficient Evidence to Support the Court’s Alter Ego Finding

Here, the court and Centurion relied primarily on assumptions and inferences drawn from the defendants’ lack of discovery responses to support a finding there was such a unity of interest and ownership between AAG and Davis such that AAG

truly did not have a separate corporate existence. Aside from those inferences, the only other evidence presented on the alter ego issue was AAG's suspended corporate status, AAG's chief operating officer's hearsay statement he was unaware Centurion made some rent payments, and evidence AAG was in default with its landlord when it induced Centurion to sublease office space. As we will explain, based on this record there is insufficient evidence to support the court's alter ego finding.

We start with the inferences of inadequate capitalization, commingling of funds, and AAG's disregard of corporate formalities. These inferences are drawn from the fact Centurion requested AAG and Davis produce their financial statements and bank records. AAG produced only one document, a Jammin Dodge Chrysler Jeep projected balance sheet. Centurion, relying on an evidentiary sanction case (*Pate v. Channel Lumber Co.* (1997) 51 Cal.App.4th 1447 (*Pate*)), argued the court properly assumed the financial documents do not exist. On appeal, Centurion boldly asserts that in light of the inadequate discovery responses, the court was *obligated* to resolve the alter ego issue against Davis. We disagree.

As noted above, Centurion had the burden of pleading and overcoming the presumption AAG had a separate corporate existence from Davis. The record shows Centurion initially recognized its burden of proof and requested the production of the following relevant documents: (1) "All financial statements for Davis"; (2) "All financial statements for AAG"; and (3) "All documents relating to, referring to, consisting of or evidencing any account maintained by Davis or AAG at any bank or similar financial institution since the time when the [AAG/Centurion] sublease was executed." Noticeably missing from the discovery inquiries were requests for documents relating to AAG's corporate formalities, such as evidence of stock certificates, questions about board or shareholder activities, or requests for copies of minutes or resolutions by AAG.

Davis and AAG objected to the first and third document production discovery requests, stating that "category of documents is not likely to lead to the

discovery of admissible evidence.” They stated they would produce financial statements for AAG “to the extent that they are in [their] control and custody.” They gave Centurion the one Jammin Dodge Chrysler Jeep balance sheet that predated the sublease agreement.

Ordinarily when there has been no response, or when a response is unsatisfactory (such as being evasive, incomplete, or containing an objection), the remedy is a motion to compel a response and/or further responses. (Code Civ. Proc., §§ 2031.300, 2031.310.) Because alter ego was adequately pled in the complaint, good cause would have certainly warranted a court order compelling production of the financial statements and other records that would reveal whether Davis was wrongly using AAG as a sham corporate entity.

It is well established that when orders to compel are disobeyed, evidentiary sanctions are appropriate. (See Weil & Brown, Cal. Practice Guide: Civil Procedure Before Trial (The Rutter Group 2008) ¶¶ 8:1498 to 8:1499, pp. 8H-36 to 8H-37.) The notable exception to this general rule is described in the *Pate* case, relied upon by Centurion. The appellate court in *Pate*, affirmed the court’s discovery sanction in a case where there had not been an order to compel, concluding, “Plaintiffs served defendant with three separate requests for production of documents and received repeated assurances from defendant that all documents had been produced. Plaintiffs were not required to move to compel further responses as a prerequisite to invoking the trial court’s discretion in imposing a discovery sanction. (See Code Civ. Proc., § 2023, subd. (b)(3).)” (*Pate, supra*, 51 Cal.App.4th at p. 1456.) The defendant in *Pate* had waited until after plaintiffs’ rested their case-in-chief to bring into court a box of documents supporting the validity of all the charges for which plaintiffs had been billed and were disputing. (*Id.* at p. 1452.) After the plaintiffs showed the court the “written assurances they received from the defense that all relevant . . . documents [regarding the

disputed charges] had been produced” the court concluded that given the late date the only appropriate sanction would be to preclude defendant from introducing any of the documents withheld from plaintiffs. (*Ibid.*) The appellate court agreed the sanction for “play[ing] fast” with the discovery rules was appropriate. (*Id.* at pp. 1454, 1456.)

The case before us is nothing like the *Pate* case. Although we do not condone the discovery gamesmanship and lack of cooperation shown by AAG and Davis, Centurion was not blindsided with unproduced evidence at trial. Centurion’s opinion financial and corporate documents never existed was not based on written assurances from AAG or Davis. To the contrary, Centurion was on notice there may be discoverable documents after it received evasive and clearly unsatisfactory responses to its document production requests. Centurion failed to pursue the matter further by making a motion to compel, or utilizing additional discovery techniques. At his deposition, Davis suggested there may be other financial documents and, not surprisingly, failed to follow through on his vague promise to look for them. Yet, Centurion did not seek the court’s assistance to compel production of these documents before trial.

We also note, Centurion provided no logical or legal explanation for its complete failure to conduct discovery and uncover documents evidencing AAG’s corporate formalities were not followed to prove its alter ego allegations. Relying on Evidence Code sections 412 and 413, Centurion suggests the court could properly consider AAG’s failure to produce any relevant documents that were in its power to locate. But this argument impermissibly shifts the burden of proof. There is no legal authority holding shareholders have the affirmative burden of disproving alter ego allegations. In addition, Centurion cited to no authority to support its theory alter ego is

an affirmative defense.¹ Perhaps this is because it is well settled the plaintiff has the burden to overcome the presumption of the separate existence of the corporate entity. (*MacPherson v. Eccleston* (1961) 190 Cal.App.2d 24, 27.)

The minimal evidence gathered by Centurion will not save the day. Centurion concedes that the fact AAG's corporate status was suspended cannot alone serve to pierce the corporate veil. A suspended corporation does not necessarily mean it was always a shell, without assets or employees. And the parties agree suspension of corporate privileges does not automatically render the principals liable for corporate debts. While we agree with the trial court's rejection of the last minute argument AAG (the California suspended corporation) merged with a similarly named Florida corporation, the court's finding does not change our analysis of the alter ego issue. The defendants' disingenuous trial tactics would reasonably cause the trial court to become highly suspicious of the credibility of AAG's and Davis's other evidence. But as stated above, it was not their burden to produce evidence to disprove alter ego liability. It was Centurion's burden to prove Davis was using the suspended corporation to accomplish a wrongful or inequitable purpose. (*Sonora Diamond, supra*, 83 Cal.App.4th at p. 539 [alter ego doctrine cannot be utilized to protect unsatisfied creditors of a corporation].)

Similarly, AAG's admission it had inadequate funds to pay the rent in January, February, and March 2005, does not support the finding Davis raided the corporation of its assets or personally pocketed the money received from Centurion in January. This fact simply showed the corporation was struggling financially for those

¹ Based on the faulty premise alter ego is an affirmative defense, Centurion faults Davis and AAG for failing to identify in answers to interrogatories the allegations in the complaint that they disputed. This misrepresents the record. The interrogatory question asked for the identification of evidence relating to affirmative defenses. Alter ego is not an affirmative defense. As stated above, it is an allegation to be pled and proven by the plaintiff.

months. There is no dispute it paid a \$33,000 security deposit just a few months prior (September 2004) as well as several months rent ending in December 2004. Moreover, the court found there was insufficient evidence of fraud: The court stated it was persuaded from the evidence “that Davis had a reasonable belief at the time he entered into the sublease agreement that he and AAG could perform on the obligations as they came due.” It logically follows from this express finding the court believed AAG experienced unanticipated hard times and could not pay its rent after December 2004.

Centurion argues the Jammin Dodge Chrysler Jeep projected balance sheet included income figures based on the assumption a transaction would be completed and AAG would obtain financing, but the deal fell through, which proves AAG never had the assets identified on the balance sheet. True, but this evidence, in and of itself, does not prove there were not other deals or transactions before or after. Nor does this evidence prove AAG lacked sufficient capitalization. As noted above, Centurion failed to go after AAG’s financial records that could have conclusively proven Davis made no effort to provide AAG with adequate capital.

Similarly, Centurion relies on statements as proof Davis treated the rental income paid to AAG as his personal funds. Michael Smith, one of Centurion’s members, testified he heard Bennington say as he was moving out of the building that he had no idea Centurion had paid some rent to AAG. This testimony standing alone is simply insufficient to prove Davis pocketed the rent money himself. Bennington was not called as a witness at the trial to be questioned about his statement. Speculation or conjecture as to why AAG’s chief operating officer was not aware Centurion paid some rent cannot support the judgment.

III

The portion of the judgment holding Davis is the alter ego of AAG, and he is jointly and severally liable for the breach of contract judgment, is reversed. The portion of the judgment finding AAG liable for \$45,256 plus prejudgment interest of \$9,757.80 is affirmed. Davis shall recover his costs on appeal.

O'LEARY, J.

WE CONCUR:

SILLS, P. J.

ARONSON, J.